

## § 1.24

## 17 CFR Ch. I (4–1–08 Edition)

or other futures commission merchant. Such withdrawal shall not result in the funds of one commodity and/or option customer being used to purchase, margin or carry the trades, contracts or commodity options, or extend the credit of any other commodity customer, option customer or other person.

[62 FR 42400, Aug. 7, 1997, as amended at 69 FR 41426, July 9, 2004]

### § 1.24 Segregated funds; exclusions therefrom.

Money held in a segregated account by a futures commission merchant shall not include: (a) Money invested in obligations or stocks of any clearing organization or in memberships in or obligations of any contract market; or (b) money held by any clearing organization which it may use for any purpose other than to purchase, margin, guarantee, secure, transfer, adjust, or settle the contracts, trades, or commodity options of the commodity or option customers of such futures commission merchant.

[46 FR 54519, Nov. 3, 1981]

### § 1.25 Investment of customer funds.

(a) *Permitted investments.* (1) Subject to the terms and conditions set forth in this section, a futures commission merchant or a derivatives clearing organization may invest customer money in the following instruments (permitted investments):

(i) Obligations of the United States and obligations fully guaranteed as to principal and interest by the United States (U.S. government securities);

(ii) General obligations of any State or of any political subdivision thereof (municipal securities);

(iii) General obligations issued by any enterprise sponsored by the United States (government sponsored enterprise securities);

(iv) Certificates of deposit issued by a bank (certificates of deposit) as defined in section 3(a)(6) of the Securities Exchange Act of 1934, or a domestic branch of a foreign bank that carries deposits insured by the Federal Deposit Insurance Corporation;

(v) Commercial paper;

(vi) Corporate notes or bonds;

(vii) General obligations of a sovereign nation; and

(viii) Interests in money market mutual funds.

(2)(i) In addition, a futures commission merchant or derivatives clearing organization may buy and sell the permitted investments listed in paragraphs (a)(1)(i) through (viii) of this section pursuant to agreements for resale or repurchase of the instruments, in accordance with the provisions of paragraph (d) of this section.

(ii) A futures commission merchant or a derivatives clearing organization may sell securities deposited by customers as margin pursuant to agreements to repurchase subject to the following:

(A) Securities subject to such repurchase agreements must be “readily marketable” as defined in § 240.15c3-1 of this title.

(B) Securities subject to such repurchase agreements must not be “specifically identifiable property” as defined in § 190.01(kk) of this chapter.

(C) The terms and conditions of such an agreement to repurchase must be in accordance with the provisions of paragraph (d) of this section.

(D) Upon the default by a counterparty to a repurchase agreement, the futures commission merchant or derivatives clearing organization shall act promptly to ensure that the default does not result in any direct or indirect cost or expense to the customer.

(3) In addition, subject to the provisions of paragraph (e) of this section, a futures commission merchant that is also registered with the Securities and Exchange Commission as a securities broker or dealer pursuant to section 15(b)(1) of the Securities Exchange Act of 1934 may enter into transactions in which:

(i) Customer money is exchanged for securities that are permitted investments and are held by the futures commission merchant in connection with its securities broker or dealer activities;

(ii) Securities deposited by customers as margin are exchanged for securities that are permitted investments and are

## Commodity Futures Trading Commission

## § 1.25

held by the futures commission merchant in connection with its securities broker or dealer activities; or

(iii) Securities deposited by customers as margin are exchanged for cash that is held by the futures commission merchant in connection with its securities broker or dealer activities.

(b) *General terms and conditions.* A futures commission merchant or a derivatives clearing organization is required to manage the permitted investments consistent with the objectives of preserving principal and maintaining liquidity and according to the following specific requirements:

(1) *Marketability.* Except for interests in money market mutual funds, investments must be "readily marketable" as defined in § 240.15c3-1 of this title.

(2) *Ratings.* (i) *Initial requirement.* Instruments that are required to be rated by this section must be rated by a nationally recognized statistical rating organization (NRSRO), as that term is defined in Securities and Exchange Commission rules or regulations, or in any applicable statute. For an investment to qualify as a permitted investment, ratings are required as follows:

(A) U.S. government securities and money market mutual funds need not be rated;

(B) Municipal securities, government sponsored enterprise securities, commercial paper, and corporate notes or bonds, except notes or bonds that are asset-backed, must have the highest short-term rating of an NRSRO or one of the two highest long-term ratings of an NRSRO;

(C) Corporate notes or bonds that are asset-backed must have the highest ratings of an NRSRO;

(D) Sovereign debt must be rated in the highest category by at least one NRSRO; and

(E) With respect to certificates of deposit, the commercial paper or long-term debt instrument of the issuer of a certificate of deposit or, if the issuer is part of a holding company system, its holding company's commercial paper or long-term debt instrument, must have the highest short-term rating of an NRSRO or one of the two highest long-term ratings of an NRSRO.

(ii) *Effect of downgrade.* If an NRSRO lowers the rating of an instrument that was previously a permitted investment on the basis of that rating to below the minimum rating required under this section, the value of the instrument recognized for segregation purposes will be the lesser of:

(A) The current market value of the instrument; or

(B) The market value of the instrument on the business day preceding the downgrade, reduced by 20 percent of that value for each business day that has elapsed since the downgrade.

(3) *Restrictions on instrument features.*

(i) With the exception of money market mutual funds, no permitted investment may contain an embedded derivative of any kind, except as follows:

(A) The issuer of an instrument otherwise permitted by this section may have an option to call, in whole or in part, at par, the principal amount of the instrument before its stated maturity date; or

(B) An instrument that meets the requirements of paragraph (b)(3)(iv) of this section may provide for a cap, floor, or collar on the interest paid; *provided, however,* that the terms of such instrument obligate the issuer to repay the principal amount of the instrument at not less than par value upon maturity.

(ii) No instrument may contain interest-only payment features.

(iii) No instrument may provide payments linked to a commodity, currency, reference instrument, index, or benchmark except as provided in paragraph (b)(3)(iv) of this section, and it may not otherwise constitute a derivative instrument.

(iv)(A) Adjustable rate securities are permitted, subject to the following requirements:

(I) The interest payments on variable rate securities must correlate closely and on an unleveraged basis to a benchmark of either the Federal Funds target or effective rate, the prime rate, the three-month Treasury Bill rate, the one-month or three-month LIBOR rate, or the interest rate of any fixed rate instrument that is a permitted investment listed in paragraph (a)(1) of this section.;

(2) The interest payment, in any period, on floating rate securities must be determined solely by reference, on an unleveraged basis, to a benchmark of either the Federal Funds target or effective rate, the prime rate, the three-month Treasury Bill rate, the one-month or three-month LIBOR rate, or the interest rate of any fixed rate instrument that is a permitted investment listed in paragraph (a)(1) of this section;

(3) Benchmark rates must be expressed in the same currency as the adjustable rate securities that reference them; and

(4) No interest payment on an adjustable rate security, in any period, can be a negative amount.

(B) For purposes of this paragraph, the following definitions shall apply:

(1) The term *adjustable rate security* means, a floating rate security, a variable rate security, or both.

(2) The term *floating rate security* means a security, the terms of which provide for the adjustment of its interest rate whenever a specified interest rate changes and that, at any time until the final maturity of the instrument or the period remaining until the principal amount can be recovered through demand, can reasonably be expected to have a market value that approximates its amortized cost.

(3) The term *variable rate security* means a security, the terms of which provide for the adjustment of its interest rate on set dates (such as the last day of a month or calendar quarter) and that, upon each adjustment until the final maturity of the instrument or the period remaining until the principal amount can be recovered through demand, can reasonably be expected to have a market value that approximates its amortized cost.

(v) Certificates of deposit, if negotiable, must be able to be liquidated within one business day or, if not negotiable, must be redeemable at the issuing bank within one business day, with any penalty for early withdrawal limited to any accrued interest earned according to its written terms.

(4) *Concentration.* (i) *Direct investments.* (A) U.S. government securities and money market mutual funds shall

not be subject to a concentration limit or other limitation.

(B) Securities of any single issuer of government sponsored enterprise securities held by a futures commission merchant or derivatives clearing organization may not exceed 25 percent of total assets held in segregation by the futures commission merchant or derivatives clearing organization.

(C) Securities of any single issuer of municipal securities, certificates of deposit, commercial paper, or corporate notes or bonds held by a futures commission merchant or derivatives clearing organization may not exceed 5 percent of total assets held in segregation by the futures commission merchant or derivatives clearing organization.

(D) Sovereign debt is subject to the following limits: a futures commission merchant may invest in the sovereign debt of a country to the extent it has balances in segregated accounts owed to its customers denominated in that country's currency; a derivatives clearing organization may invest in the sovereign debt of a country to the extent it has balances in segregated accounts owed to its clearing member futures commission merchants denominated in that country's currency.

(ii) *Repurchase agreements.* For purposes of determining compliance with the concentration limits set forth in this section, securities sold by a futures commission merchant or derivatives clearing organization subject to agreements to repurchase shall be combined with securities held by the futures commission merchant or derivatives clearing organization as direct investments.

(iii) *Reverse repurchase agreements.* For purposes of determining compliance with the concentration limits set forth in this section, securities purchased by a futures commission merchant or derivatives clearing organization subject to agreements to resell shall be combined with securities held by the futures commission merchant or derivatives clearing organization as direct investments.

(iv) *Transactions under paragraph (a)(3).* For purposes of determining compliance with the concentration

limits set forth in this section, securities transferred to a customer segregated account pursuant to paragraphs (a)(3)(i) or (a)(3)(ii) of this section shall be combined with securities held by the futures commission merchant as direct investments.

(v) *Treatment of securities issued by affiliates.* For purposes of determining compliance with the concentration limits set forth in this section, securities issued by entities that are affiliated, as defined in paragraph (b)(6) of this section, shall be aggregated and deemed the securities of a single issuer. An interest in a permitted money market mutual fund is not deemed to be a security issued by its sponsoring entity.

(vi) *Treatment of customer-owned securities.* For purposes of determining compliance with the concentration limits set forth in this section, securities owned by the customers of a futures commission merchant and posted as margin collateral are not included in total assets held in segregation by the futures commission merchant, and securities posted by a futures commission merchant with a derivatives clearing organization are not included in total assets held in segregation by the derivatives clearing organization.

(5) *Time-to-maturity.* (i) Except for investments in money market mutual funds, the dollar-weighted average of the time-to-maturity of the portfolio, as that average is computed pursuant to §270.2a-7 of this title, may not exceed 24 months.

(ii) For purposes of determining the time-to-maturity of the portfolio, an instrument that is set forth in paragraphs (a)(1)(i) through (vii) of this section may be treated as having a one-day time-to-maturity if the following terms and conditions are satisfied:

(A) The instrument is deposited solely on an overnight basis with a derivatives clearing organization pursuant to the terms and conditions of a collateral management program that has become effective in accordance with §39.4 of this chapter;

(B) The instrument is one that the futures commission merchant owns or has an unqualified right to pledge, is not subject to any lien, and is deposited by the futures commission mer-

chant into a segregated account at a derivatives clearing organization;

(C) The derivatives clearing organization prices the instrument each day based on the current mark-to-market value; and

(D) The derivatives clearing organization reduces the assigned value of the instrument each day by a haircut of at least 2 percent.

(6) *Investments in instruments issued by affiliates.* (i) A futures commission merchant shall not invest customer funds in obligations of an entity affiliated with the futures commission merchant, and a derivatives clearing organization shall not invest customer funds in obligations of an entity affiliated with the derivatives clearing organization. An affiliate includes parent companies, including all entities through the ultimate holding company, subsidiaries to the lowest level, and companies under common ownership of such parent company or affiliates.

(ii) A futures commission merchant or derivatives clearing organization may invest customer funds in a fund affiliated with that futures commission merchant or derivatives clearing organization.

(7) *Recordkeeping.* A futures commission merchant and a derivatives clearing organization shall prepare and maintain a record that will show for each business day with respect to each type of investment made pursuant to this section, the following information:

(i) The type of instruments in which customer funds have been invested;

(ii) The original cost of the instruments; and

(iii) The current market value of the instruments.

(c) *Money market mutual funds.* The following provisions will apply to the investment of customer funds in money market mutual funds (the fund).

(1) The fund must be an investment company that is registered under the Investment Company Act of 1940 with the Securities and Exchange Commission and that holds itself out to investors as a money market fund, in accordance with §270.2a-7 of this title.

(2) The fund must be sponsored by a federally-regulated financial institution, a bank as defined in section 3(a)(6) of the Securities Exchange Act

of 1934, an investment adviser registered under the Investment Advisers Act of 1940, or a domestic branch of a foreign bank insured by the Federal Deposit Insurance Corporation.

(3) A futures commission merchant or derivatives clearing organization shall maintain the confirmation relating to the purchase in its records in accordance with § 1.31 and note the ownership of fund shares (by book-entry or otherwise) in a custody account of the futures commission merchant or derivatives clearing organization in accordance with § 1.26(a). If the futures commission merchant or the derivatives clearing organization holds its shares of the fund with the fund's shareholder servicing agent, the sponsor of the fund and the fund itself are required to provide the acknowledgment letter required by § 1.26.

(4) The net asset value of the fund must be computed by 9 a.m. of the business day following each business day and made available to the futures commission merchant or derivatives clearing organization by that time.

(5) (i) General requirement for redemption of interests. A fund shall be legally obligated to redeem an interest and to make payment in satisfaction thereof by the business day following a redemption request, and the futures commission merchant or derivatives clearing organization shall retain documentation demonstrating compliance with this requirement.

(ii) Exception. A fund may provide for the postponement of redemption and payment due to any of the following circumstances:

(A) Non-routine closure of the Fedwire or applicable Federal Reserve Banks;

(B) Non-routine closure of the New York Stock Exchange or general market conditions leading to a broad restriction of trading on the New York Stock Exchange;

(C) Declaration of a market emergency by the Securities and Exchange Commission; or

(D) Emergency conditions set forth in section 22(e) of the Investment Company Act of 1940.

(6) The agreement pursuant to which the futures commission merchant or derivatives clearing organization has

acquired and is holding its interest in a fund must contain no provision that would prevent the pledging or transferring of shares.

(d) *Repurchase and reverse repurchase agreements.* A futures commission merchant or derivatives clearing organization may buy and sell the permitted investments listed in paragraphs (a)(1)(i) through (viii) of this section pursuant to agreements for resale or repurchase of the securities (agreements to repurchase or resell), provided the agreements to repurchase or resell conform to the following requirements:

(1) The securities are specifically identified by coupon rate, par amount, market value, maturity date, and CUSIP or ISIN number.

(2) Counterparties are limited to a bank as defined in section 3(a)(6) of the Securities Exchange Act of 1934, a domestic branch of a foreign bank insured by the Federal Deposit Insurance Corporation, a securities broker or dealer, or a government securities broker or government securities dealer registered with the Securities and Exchange Commission or which has filed notice pursuant to section 15C(a) of the Government Securities Act of 1986.

(3) The transaction is executed in compliance with the concentration limit requirements applicable to the securities transferred to the customer segregated custodial account in connection with the agreements to repurchase referred to in paragraphs (b)(4)(ii) and (iii) of this section.

(4) The transaction is made pursuant to a written agreement signed by the parties to the agreement, which is consistent with the conditions set forth in paragraphs (d)(1) through (d)(12) of this section and which states that the parties thereto intend the transaction to be treated as a purchase and sale of securities.

(5) The term of the agreement is no more than one business day, or reversal of the transaction is possible on demand.

(6) Securities transferred to the futures commission merchant or derivatives clearing organization under the agreement are held in a safekeeping account with a bank as referred to in paragraph (d)(2) of this section, a derivatives clearing organization, or the

## Commodity Futures Trading Commission

## § 1.25

Depository Trust Company in an account that complies with the requirements of §1.26.

(7) The futures commission merchant or the derivatives clearing organization may not use securities received under the agreement in another similar transaction and may not otherwise hypothecate or pledge such securities, except securities may be pledged on behalf of customers at another futures commission merchant or derivatives clearing organization. Substitution of securities is allowed, *provided, however, that*:

(i) The qualifying securities being substituted and original securities are specifically identified by date of substitution, market values substituted, coupon rates, par amounts, maturity dates and CUSIP or ISIN numbers;

(ii) Substitution is made on a "delivery versus delivery" basis; and

(iii) The market value of the substituted securities is at least equal to that of the original securities.

(8) The transfer of securities to the customer segregated custodial account is made on a delivery versus payment basis in immediately available funds. The transfer of funds to the customer segregated cash account is made on a payment versus delivery basis. The transfer is not recognized as accomplished until the funds and/or securities are actually received by the custodian of the futures commission merchant's or derivatives clearing organization's customer funds or securities purchased on behalf of customers. The transfer or credit of securities covered by the agreement to the futures commission merchant's or derivatives clearing organization's customer segregated custodial account is made simultaneously with the disbursement of funds from the futures commission merchant's or derivatives clearing organization's customer segregated cash account at the custodian bank. On the sale or resale of securities, the futures commission merchant's or derivatives clearing organization's customer segregated cash account at the custodian bank must receive same-day funds credited to such segregated account simultaneously with the delivery or transfer of securities from the customer segregated custodial account.

(9) A written confirmation to the futures commission merchant or derivatives clearing organization specifying the terms of the agreement and a safekeeping receipt are issued immediately upon entering into the transaction and a confirmation to the futures commission merchant or derivatives clearing organization is issued once the transaction is reversed.

(10) The transactions effecting the agreement are recorded in the record required to be maintained under §1.27 of investments of customer funds, and the securities subject to such transactions are specifically identified in such record as described in paragraph (d)(1) of this section and further identified in such record as being subject to repurchase and reverse repurchase agreements.

(11) An actual transfer of securities to the customer segregated custodial account by book entry is made consistent with Federal or State commercial law, as applicable. At all times, securities received subject to an agreement are reflected as "customer property."

(12) The agreement makes clear that, in the event of the bankruptcy of the futures commission merchant or derivatives clearing organization, any securities purchased with customer funds that are subject to an agreement may be immediately transferred. The agreement also makes clear that, in the event of a futures commission merchant or derivatives clearing organization bankruptcy, the counterparty has no right to compel liquidation of securities subject to an agreement or to make a priority claim for the difference between current market value of the securities and the price agreed upon for resale of the securities to the counterparty, if the former exceeds the latter.

(e) *Transactions by futures commission merchants that are also registered securities brokers or dealers.* A futures commission merchant that is also registered with the Securities and Exchange Commission as a securities broker or dealer pursuant to section 15(b)(1) of the Securities Exchange Act of 1934 may enter into transactions

pursuant to paragraph (a)(3) of this section, subject to the following requirements:

(1) The futures commission merchant, in connection with its securities broker or dealer activities, owns or has the unqualified right to pledge the securities that are exchanged for customer money or securities held in the customer segregated account.

(2) The transaction can be reversed within one business day or upon demand.

(3) Securities transferred from the customer segregated account and securities transferred to the customer segregated account as a result of the transaction are specifically identified by coupon rate, par amount, market value, maturity date, and CUSIP or ISIN number.

(4) Securities deposited by customers as margin and transferred from the customer segregated account as a result of the transaction are subject to the following requirements:

(i) The securities are “readily marketable” as defined in §240.15c3-1 of this title.

(ii) The securities are not “specifically identifiable property” as defined in §190.01(kk) of this chapter.

(5) Securities transferred to the customer segregated account as a result of the transaction are subject to the following requirements:

(i) The securities are priced each day based on the current mark-to-market value.

(ii) The securities are subject to the concentration limit requirements set forth in paragraph (b)(4)(iv) of this section.

(iii) The securities are held in a safe-keeping account with a bank, as referred to in paragraph (d)(2) of this section, a derivatives clearing organization, or the Depository Trust Company in an account that complies with the requirements of §1.26.

(iv) The securities may not be used in another similar transaction and may not otherwise be hypothecated or pledged, except such securities may be pledged on behalf of customers at another futures commission merchant or derivatives clearing organization. Substitution of securities is allowed, *provided, however*, that:

(A) The qualifying securities being substituted and original securities are specifically identified by date of substitution, market values substituted, coupon rates, par amounts, maturity dates and CUSIP or ISIN numbers;

(B) Substitution is made on a “delivery versus delivery” basis; and

(C) The market value of the substituted securities is at least equal to that of the original securities.

(6) The transactions are carried out in accordance with the following procedures:

(i) With respect to transactions under paragraph (a)(3)(i) of this section, the transfer of securities to the customer segregated custodial account shall be made simultaneously with the transfer of money from the customer segregated cash account. In no event shall money held in the customer segregated cash account be disbursed prior to the transfer of securities to the customer segregated custodial account. Any transfer of securities to the customer segregated custodial account shall not be recognized as accomplished until the securities are actually received by the custodian of such account. Upon unwinding of the transaction, the customer segregated cash account shall receive same-day funds credited to such account simultaneously with the delivery or transfer of securities from the customer segregated custodial account.

(ii) With respect to transactions under paragraph (a)(3)(ii) of this section, the transfer of securities to the customer segregated custodial account shall be made simultaneously with the transfer of securities from the customer segregated custodial account. In no event shall securities held in the customer segregated custodial account be released prior to the transfer of securities to that account. Any transfer of securities to the customer segregated custodial account shall not be recognized as accomplished until the securities are actually received by the custodian of the customer segregated custodial account. Upon unwinding of the transaction, the customer segregated custodial account shall receive the securities simultaneously with the delivery or transfer of securities from

## Commodity Futures Trading Commission

## § 1.26

the customer segregated custodial account.

(iii) With respect to transactions under paragraph (a)(3)(iii) of this section, the transfer of money to the customer segregated cash account shall be made simultaneously with the transfer of securities from the customer segregated custodial account. In no event shall securities held in the customer segregated custodial account be released prior to the transfer of money to the customer segregated cash account. Any transfer of money to the customer segregated cash account shall not be recognized as accomplished until the money is actually received by the custodian of the customer segregated cash account. Upon unwinding of the transaction, the customer segregated custodial account shall receive the securities simultaneously with the disbursement of money from the customer segregated cash account.

(7) The futures commission merchant maintains all books and records with respect to the transactions in accordance with §§ 1.25, 1.27, 1.31, and 1.36 and the applicable rules and regulations of the Securities and Exchange Commission.

(8) An actual transfer of securities by book entry is made consistent with Federal or State commercial law, as applicable. At all times, securities transferred to the customer segregated account are reflected as "customer property."

(9) For purposes of §§ 1.25, 1.26, 1.27, 1.28 and 1.29, securities transferred to the customer segregated account are considered to be customer funds until the customer money or securities for which they were exchanged are transferred back to the customer segregated account. In the event of the bankruptcy of the futures commission merchant, any securities exchanged for customer funds and held in the customer segregated account may be immediately transferred.

(10) In the event the futures commission merchant is unable to return to the customer any customer-deposited securities exchanged pursuant to paragraphs (a)(3)(ii) or (a)(3)(iii) of this section, the futures commission merchant shall act promptly to ensure that such inability does not result in any direct

or indirect cost or expense to the customer.

(f) *Deposit of firm-owned securities into segregation.* A futures commission merchant shall not be prohibited from directly depositing unencumbered securities of the type specified in this section, which it owns for its own account, into a segregated safekeeping account or from transferring any such securities from a segregated account to its own account, up to the extent of its residual financial interest in customers' segregated funds; provided, however, that such investments, transfers of securities, and disposition of proceeds from the sale or maturity of such securities are recorded in the record of investments required to be maintained by § 1.27. All such securities may be segregated in safekeeping only with a bank, trust company, derivatives clearing organization, or other registered futures commission merchant. Furthermore, for purposes of §§ 1.25, 1.26, 1.27, 1.28 and 1.29, investments permitted by § 1.25 that are owned by the futures commission merchant and deposited into such a segregated account shall be considered customer funds until such investments are withdrawn from segregation.

[70 FR 28200, May 17, 2005; 70 FR 32866, June 6, 2005]

### **§ 1.26 Deposit of instruments purchased with customer funds.**

(a) Each futures commission merchant who invests customer funds in instruments described in § 1.25 shall separately account for such instruments and segregate such instruments as belonging to such commodity or option customers. Such instruments, when deposited with a bank, trust company, clearing organization or another futures commission merchant, shall be deposited under an account name which clearly shows that they belong to commodity or option customers and are segregated as required by the Act and this part. Each futures commission merchant upon opening such an account shall obtain and retain in its files an acknowledgment from such bank, trust company, clearing organization or other futures commission merchant that it was informed that the instruments belong to commodity or